EX PARTE: IN THE MATTER CONCERNING THE AGGREGATION OF RETAIL ELECTRIC CUSTOMERS UNDER THE PROVISIONS OF THE VIRGINIA ELECTRIC UTILITY RESTRUCTURING ACT CASE NO. PUE-2002-00174 STAFF REPORT

BACKGROUND

By Order dated March 18, 2002, the Virginia State Corporation Commission ("Commission") initiated a proceeding, Case No. PUE-2002-00174, establishing an investigation to further assist in the development and refinement of appropriate policies, rules, and regulations for the provision of aggregation service. Three areas of inquiry were identified: (i) licensing of aggregators, (ii) contractual relationships between aggregators and their customers (and also as between aggregators and suppliers or other aggregators), and (iii) the impact of incumbent electric utilities' relationships with their aggregator affiliates on the development of effective competition within the Commonwealth. The Commission ordered its Staff to conduct the investigation with input from a working group ("Work Group"). The Commission also ordered that, on or before August 1, 2002, the Commission Staff should file a report detailing the results of its investigation, together with any proposed changes to the Commission's Rules Governing Retail Access to Competitive Energy Services ("Retail Access Rules") 20 VAC 5-312-10 et seq.

WORK GROUP

The Work Group met May 1, 2002, to discuss the issues outlined in the Commission's Order. In addition to Commission Staff members, there were approximately 25 participants present at the May

1 meeting. These participants represented varied interests including utilities, competitive service providers ("CSPs"), aggregators, and municipalities. A list of attendees is attached as Exhibit 1.

The Work Group addressed the three main issues outlined in the Commission's Order (licensing, contractual relationships, and impact of incumbent utilities' aggregator affiliates) as well as other issues advanced by group members. From that discussion, the Staff identified the following six key issues that it believed might warrant further consideration.

1. The definition of "Aggregator" in §56-576 of the Code of Virginia includes a person that "…offers to purchase, or purchases, electric energy…". The definition of "Aggregator" in the Commission's Rules Governing Retail Access ("Rules") mirrors this language but includes natural gas in addition to electric energy. A few group participants questioned the inclusion of the reference to purchasing energy in the aggregator definition. If a company purchases energy for a retail customer, wouldn't that company be a competitive service provider? The fact that an aggregator might offer to purchase or purchase energy may cause an LDC to treat that aggregator the same as a CSP for purposes of the LDC registration procedure. For example, an LDC might require the aggregator to go through EDI testing, fill out various supplier forms and post appropriate financial security. The Work Group queried whether the clause "…offers to purchase, or purchases, electric energy…" in the aggregator definition could be removed in the interest of eliminating this uncertainty, without changing the intended applicability of this statutory definition?

2. The Code's definition of "Aggregator" excludes a person furnishing educational, informational, or analytical services to two or more retail customers, unless direct or indirect compensation for such services is paid by an aggregator or supplier of electric energy. The definition of "Aggregator" in the Rules mirrors this language except that the compensation may be from a competitive service provider supplying electricity or natural gas, or both. The group discussed whether compensation from a supplier should serve as a determining factor for licensure from a practical perspective. As an example, should the Commission be concerned if a trade association, acting as an aggregator for its members, is being compensated by a supplier for its expenses in marketing an aggregation program? Or should the distinction be made on the basis of whether any person or entity is actually engaged in aggregation as a business and receiving compensation as an aggregator? Put simply, should licensing be required of any person or entity that is not directly engaged in the business of aggregation but is nevertheless receiving compensation from a CSP or aggregator, e.g., in conjunction with marketing assistance?

3. The group discussed the idea of establishing two levels of licensure for aggregators. The higher level would follow our current process for licensure. That licensed aggregator would have access to each utility's mass customer information list. The lower level might be a registration process with a less

involved filing and lower filing fee. This lower level aggregator might not be granted access to the utility's mass customer information list.

4. Closely related to item 3., the group discussed the general question of which types of aggregators need a license. Could the aggregator's need for the utility's mass customer list be the determining factor? The group generally agreed that using the need for a mass list as the "bright line" to determine the need to be licensed does not conform to either the statute or Retail Access Rules.

5. With respect to the relationship between an aggregator and its customers, should there be provisions in the Rules related to contract length or liquidated damages? There are no such restrictions on CSPs. Why should additional requirements apply to aggregators? This question led to a discussion of whether additional protections are needed for residential customers entering into contracts with aggregators. Commercial and industrial customers are generally perceived to be more sophisticated in making energy choices and, therefore, more capable of looking out for their own interests. Residential customers, however, are not viewed as having similar expertise. Should there be additional rules to protect residential customers with respect to aggregation contract terms and conditions?

6. The Commission's Order directed the group to consider the impact of incumbent electric utilities' relationships with their aggregator affiliates on the development of effective competition within the Commonwealth. The group generally discussed market power issues, i.e., whether affiliate transactions are arms' length transactions, and whether name recognition (or branding) is a significant issue or source of concern. None of the participants present expressed concern over affiliates of utilities participating as aggregators. In fact, at least one participant thought that such an affiliate could be helpful to market development.

In addition to the issues identified in the Commission's Order, the Work Group briefly discussed municipal aggregation. The parties discussed the pros and cons of the opt-in versus opt-out provision for municipal customers. Under current law, as adopted in 1999,[1] municipalities can aggregate electricity customers within their political boundaries on an "opt-in" basis only, i.e., such customers must affirmatively elect to participate in a municipally-established aggregation group. The Work Group did not suggest any changes related to the municipal aggregation portion of the Restructuring Act. Staff has no recommendations concerning municipal aggregation at this time.

[1] § 56-589 A 1 of the Restructuring Act provides that municipalities and other political subdivisions of the Commonwealth may aggregate industrial, commercial and residential customers within their boundaries on a "voluntary, opt-in basis."

In an e-mail sent to Work Group members and many other interested parties, Staff requested comments on the six issues above as well as any other general comments about making

aggregation work in Virginia. Six parties filed comments: Retail Merchants Association ("RMA"), Energy Consultants, Inc. ("ECI"), the Virginia Electric Cooperatives ("Cooperatives")[2], Dominion Retail, Inc. ("Dominion Retail"), Dominion Virginia Power ("DVP"), and American Electric Power ("AEP"). A copy of each of these comments is included as Exhibit 2. Several other parties contacted Staff to indicate their on-going interest in the proceeding but noted that they did not plan to file specific comments at this time. At least some of these parties indicated that they are awaiting proposed changes to the Rules or applicable statutes before providing comments.

SUMMARY OF COMMENTS

As noted above, following the Work Group meeting, comments were received from six parties regarding the aggregation issues identified by Staff. Three parties commented specifically on each of the six issues identified by Staff while the remaining parties provided more general comments. Specific comments for the identified issues are summarized below and followed by a summary of the more general comments.

Issue #1.

Dominion Retail states that it may not be desirable to remove the "offers to purchase" clause from the definition of aggregator because doing so may cause confusion and possibly create a regulatory gap. Dominion Retail offers an example of an aggregator that signs up customers as part of a known supply offer (by "known supply", Staff presumes Dominion Retail

[2] In this case, Virginia Electric Cooperatives include A&N Electric Cooperative, BARC Electric Cooperative, Central Virginia Electric Cooperative, Community Electric Cooperative, Craig-Botetourt Electric Cooperative, Mecklenburg Electric Cooperative, Northern Neck Electric Cooperative, Inc., Northern Virginia Electric Cooperative, Powell Valley Electric Cooperative, Prince George Electric Cooperative, Rappahannock Electric Cooperative, Shenandoah Valley Electric Cooperative, and Southside Electric Cooperative.

is referring to purchased supply). In this case, Dominion Retail indicates that the aggregator might very well act as the supplier. Dominion Retail states that, even though there may be an overlap between the current definitions of aggregator and CSP, it is perhaps premature to change the Rules at this time.

In its comments, DVP draws the distinction between an aggregator that acts as a purchasing agent on behalf of customers and a competitive service provider who purchases electricity in its own name "for sale to" customers. DVP states that clarification of the definition would be helpful and notes that it would not oppose a change in the definition.

ECI agrees that the aggregator definition could be changed without changing the intended applicability of the definition.

Issue #2.

Dominion Retail notes that if a trade association simply assists a licensed aggregator in communicating the availability of the licensed aggregator's program to its members (i.e., simply marketing an aggregation program), licensure of the trade association should not be required, even if the trade association is compensated.

DVP believes that a distinction should be made on the basis of whether any person or entity is actually engaged in aggregation as a for-profit business. DVP asserts that licensing should not be necessary for such groups as churches, neighborhood associations or trade groups that are not directly engaged in the business of aggregation but may be receiving "token" compensation from a CSP or aggregator.

ECI believes that the source of compensation is not as much of an issue as the services rendered or the contractual relationship. ECI states that if a trade association obtained an offer from a CSP without any commitment as to how many members might accept the offer and the association is

simply being paid by a CSP to market that CSP to its members, ECI does not believe that function would be aggregation.

Issue #3.

None of the issue-specific comments supported the suggestion of two levels of aggregators.

Issue #4.

DVP, Dominion Retail, and ECI agree that access to the mass list should not be a criterion for licensing.

Issue #5.

The three parties generally agreed that there was no need for new rules related to contracts between customers and aggregators, and that aggregators should not be subject to stricter requirements than CSPs.

Issue #6.

Dominion Retail and DVP both reference existing codes of conduct in the retail access rules (20 VAC 5-312-30) that govern various aspects of the relationship between a utility and its affiliates in retail access. DVP states that those codes have been shown to provide adequate protection.

ECI believes that there is an issue related to the market power of branding (i.e., name or logo familiarity). ECI notes that a successful transition to competition requires that customers feel comfortable with shifting to an alternative supplier. ECI seems to suggest that the role of the affiliated aggregator needs to be monitored as the competitive market develops.

General Comments

AEP notes in its comments that the Commission should adopt rules to encourage aggregation. For that reason, AEP would endorse relaxed licensing rules for aggregators that arrange for aggregated

power purchase but do not purchase and resell electric power themselves. AEP believes that aggregators that purchase and resell electric power are essentially competitive electricity suppliers and should be licensed as such.

AEP states that aggregation should not complicate the relationships among the market participants actually generating and delivering electric power to customers. AEP asserts that local distribution companies should not be required to deal with more than one party to arrange the receipt and delivery of electricity to distribution customers. For example, according to AEP, Commission rules should relieve the local distribution company from any obligation to engage in electronic data transfer with an aggregator that is not also the generation supplier for a customer.

AEP asserts that aggregators that are affiliates of incumbent electric utilities should not be treated differently than aggregators that are not so affiliated. If any rule changes are considered with respect to affiliated aggregators, AEP states that a relaxation of the current Rules would encourage aggregation and promote competition.

The Cooperatives note that they are interested in promoting any viable retail access strategies that generate economic savings for consumer/owners. The Cooperatives state that they are most interested in (i) ensuring consumer protection for their membership and (ii) clarifying their legal responsibilities as incumbent utilities when dealing with aggregators. The Cooperatives believe that including "aggregators" by reference within the definition of "competitive service providers" may cause unintended consequences.

The Cooperatives do not support establishing two levels of licensure for aggregators as that change might serve to confuse consumers. The Cooperatives believe that any entity performing

aggregator functions should be licensed and that utilities should only provide customer information (such as the mass list) to entities that have been properly licensed by the Commission.

The RMA focused its comments on the issue of who needs a license. The RMA urges the SCC to take no action that would require an organization acting in an intermediary role in bringing together suppliers and customers to be licensed. The RMA notes that intermediaries are not in the business of providing electricity to retail customers, and they cannot provide the consumer protections and technical expertise that licensed aggregators are meant to provide under the Rules.

The RMA lists specific rules that apply to aggregators but should not apply to intermediaries. In general, these rules already apply to the CSP or aggregator that the intermediary brings together with the customer and thus, according to the RMA, no useful purpose is served by having these rules apply to the intermediary as well. The RMA offers several ways to resolve its issues. The Commission could retain the status quo, in which, in the RMA's opinion, neither the Act nor the Rules require the organization serving as an intermediary to be licensed as an aggregator. Another alternative offered by the RMA would be to have the Commission revise the Rules to clarify that "aggregator" excludes intermediaries who are not in the principal business of providing retail electricity generation. Yet another alternative proposed by the RMA would be to have the Commission state under § 20 VAC 5-312-10 that an aggregator is deemed to be a competitive service provider for the purposes of the Retail Access Rules only when the principal business of such aggregator is selling electricity at retail.

STAFF RECOMMENDATIONS

The Commission's March 18, 2002 Order identified three areas of inquiry regarding aggregation: (i) licensing of aggregators, (ii) contractual relationships between aggregators and their customers (and also as between aggregators and suppliers or other aggregators), and (iii) the impact of

incumbent electric utilities' relationships with their aggregator affiliates on the development of effective competition. Based on Staff's investigation and the input of the Work Group, it appears that the first item, licensing of aggregators, creates the most questions and confusion. There continue to be outstanding questions related to the applicability of licensure requirements to certain entities, particularly those solely providing marketing services. In addition, several parties supported a change in the definition of aggregator.

The remaining areas defined in the Order do not warrant further discussion or change at this time. Regarding contractual relationships, the majority Work Group opinion is that there should be no more stringent requirements applied to aggregators than to CSPs. Regarding incumbent electric utilities' affiliates providing aggregation services, most parties commented that the existing codes of conduct were adequate.

Aggregator Definition

The definition of aggregation generated a great deal of discussion among the Work Group members. While the group discussed several aspects of the definition, it focused on the notion of aggregators purchasing energy—a concept embodied in the definition. In the view of one utility's representative present at the work group's meeting, that portion of the Code's definition that includes "…offers to purchase, or purchases, electric energy…" could cause aggregators to be treated just like CSPs. Consequently (in this individual's view), aggregators might be required to go through the complete CSP registration process, including possibly posting financial security and passing EDI testing with the utility. However, and as a response to that concern, Staff notes that a person applying for a license may seek relief from provisions of the rules that would seem inapplicable to that applicant's circumstances or intentions. As provided in 20 VAC 5-312-20 A, an entity applying for a license may

request that the Commission consider granting a waiver of certain provisions of the Rules. If an aggregator is conducting business in such a way that it does not believe that EDI compliance or certain parts of the registration process with the incumbent utility are necessary, it may request a waiver of the rules related to those requirements. Further, with regards to EDI certification, under 20 VAC 5-312-20 L, such certification is only necessary for an entity responsible for exchanging information electronically with a utility to be EDI certified. An aggregator might not need to communicate electronically with a utility; it may be communicating with a CSP only. Based on that distinction and the waiver provision, Staff does not recommend a change to the current definition of aggregator in § 56-576 of the Restructuring Act. We will continue to consider the appropriateness of such a change as retail competition develops.

Marketing Exclusion

The Work Group discussed whether some easily-applied test could help determine whether an entity needs to be licensed as an aggregator. Some parties in the Work Group suggested that the need for a license should be based upon whether or not the entity is "in the business" of providing aggregation services. That discussion, in turn, led to the group's review of an important question: should licensing as an aggregator be required of any person or entity that is not directly engaged "in the business" of aggregation but is nevertheless receiving compensation from a CSP or aggregator, e.g., in conjunction with marketing assistance? Of course, answering that question first requires defining the "business" of aggregation - the very issue that prompted this licensing inquiry, and one that is problematic by its very nature.

In Staff's view, the better approach may be to address the "marketing" issue directly, since it is an issue that prompted, in large part, the Commission's investigation into aggregation issues, and the one

that has consumed a large amount of Staff time and resources. The marketing issue also received a significant amount of work group attention as well. Put simply, the issue devolves to the following question: Should any person who, for compensation, endorses or promotes the products or services of a licensed CSP or aggregator be licensed? Thus, to the extent a trade association, for example, enters into a "co-branding," "affinity"[3] or other promotional relationship with a licensed CSP or licensed aggregator in which it is compensated for such product endorsement on the basis of customers enrolled or on some other basis (but has no role in the actual procurement of electric power), should that trade association be required to obtain an aggregator's license?

Part of the answer lies in the definition of "aggregator" adopted by the 2001 Session of the General Assembly, and now incorporated into § 56-576 of the Restructuring Act, as discussed earlier in this report. When reduced to its essentials, an aggregator under this definition is a person functioning in an agency or intermediary capacity who *facilitates* the sale of electricity to retail customers.

It seems to Staff that in the trade association promotional relationship described above, the trade association is involved in promoting customer relationships between CSPs/aggregators and targeted individuals or groups who might be influenced by the association's endorsement. However, to the extent that the trade association's involvement is limited to endorsement and promotion (albeit for compensation), and does not actually extend to facilitating the *procurement of the electricity,* licensing

[3] By "co-branding" and "affinity" relationships, the Staff is referring to relationships common in the credit card industry in which for example, a credit card issuer might strike a bargain with a college or university in which the students or alumni of that institution are solicited by the issuer to apply for credit cards bearing the institution's name or seal. The college or university's only interest in this arrangement is a financial one: typically, a small percentage of the total purchases on such cards is paid to the institution. However, the institution has no say in determining eligibility, creditworthiness or issuance; that determination is exclusively within the province of the card issuer.

as an aggregator should not be required. Put simply, the agent who arranges the sale should be treated more strictly than someone who merely recommends the agent.

The Staff believes that the Restructuring Act's current language permits the Commission to draw such distinctions for purposes of licensing; moreover, drawing such distinctions between a transactional player and a simple endorser/promoter seems consistent with the public interest. Colleges and universities, for example, may profit from "co-branding" or "affinity" relationships with certain credit card issuers (see footnote 3), but are not, to the best of Staff's knowledge, required to obtain financial licensure identical to that of the card issuers. At bottom, Staff's view is that the issue is much simplified by distinguishing between those *promoting* the provider of a product versus those *providing* (or offering to provide or making arrangements to provide) for the delivery of that product.

Thus, in Staff's view, if the trade association described above stays out of the *transactional* arrangements between licensed CSPs and/or licensed aggregators and retail customers, licensing as an aggregator should not, in the ordinary course of events, be required. This would seem to be a sensible construction of the existing statutory language in §§ 56-576 and 56-588; thus, no statutory amendments should be needed for the Commission to implement such a view.

As discussed above, the Staff does not believe that marketing activities, alone, conducted on behalf of, or in conjunction, with licensed CSPs or aggregators warrant licensure of third parties participating in those activities. However, the Staff would note that the provisions of § 56-593 of the Restructuring Act could likely be enforced against such licensees for marketing activities conducted by

third parties (in conjunction with such licensees or on their behalf) causing harm to members of the general public.[4]

Finally, for purposes of ensuring protection of the public, the Commission should consider amending 20 VAC 5-312-20 to require all CSPs and aggregators to maintain in their books and records, on an ongoing basis, information identifying persons or entities with whom they have marketing relationships. Such information would be available to assist this Commission in carrying out its obligations under § 56-593, discussed above, with respect to any CSP or aggregator marketing practices emanating from such relationships that cause harm to members of the public.

CONCLUSIONS

Based on our investigation and input from the Work Group and other interested parties, Staff recommends the following change to the current Retail Access Rules:

Modify 20 VAC 5-312-20 D to require the CSP to maintain a list of entities with whom it has a marketing relationship. The modified rule would state, "The State Corporation Commission maintains the right to inspect the books, papers, records and documents, and to require reports and statements, of a competitive service provider as required to verify qualifications to conduct business within the Commonwealth, to support affiliate transactions, to investigate allegations of violations of this chapter, to resolve a complaint failed against a competitive service provider, or to identify persons or entities performing promotional or marketing activities on behalf of or in conjunction with a competitive service provider."

[4] Section 56-593 B 1 establishes a private right of action in favor of persons sustaining loos as a result of marketing

practices of licensed suppliers, aggregators or public service companies.